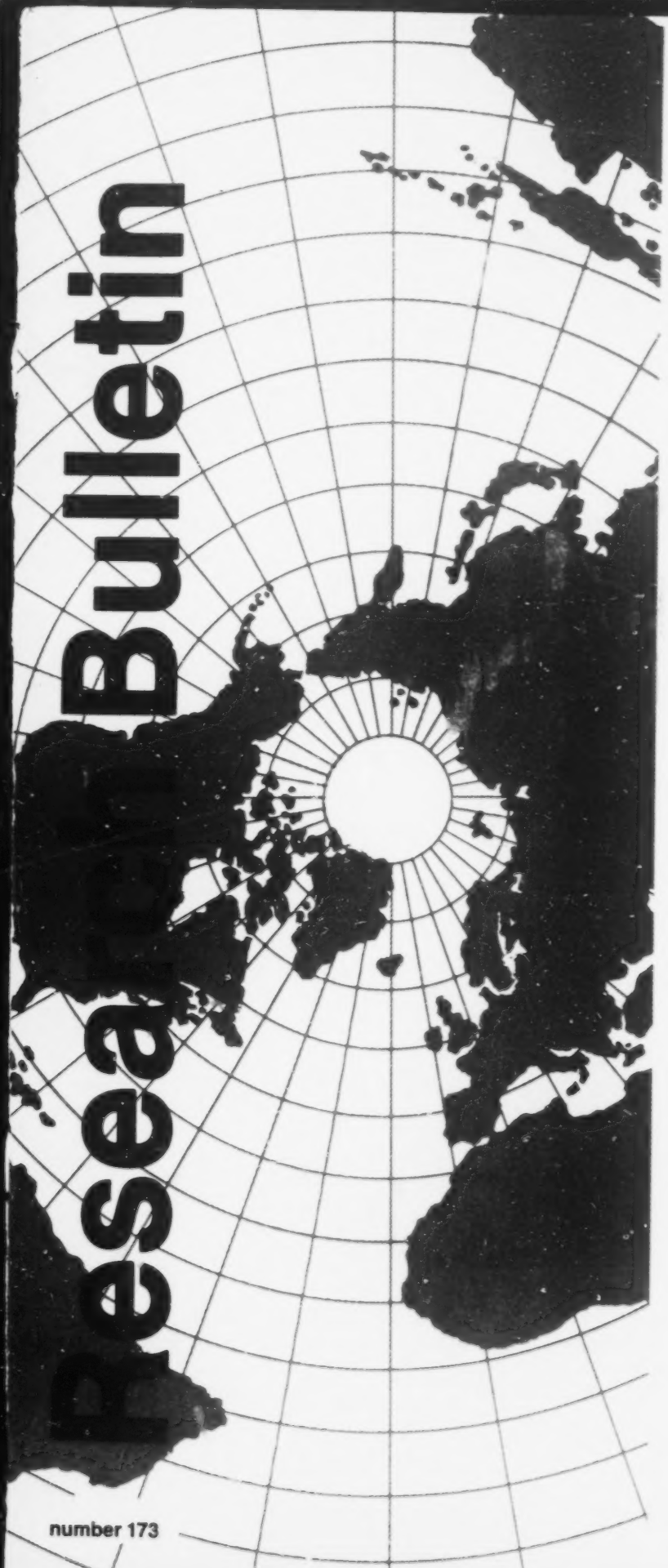
4/3/85 R 4105-29.50 A



Research Bulletin

number 173

Top Executive Compensation in U.S.-Based Multinationals

by Harland Fox

The Conference Board

© 1985 The Conference Board, Inc.

THE CONFERENCE BOARD, INC.
845 Third Avenue, New York, N.Y. 10022
THE CONFERENCE BOARD OF CANADA
25 McArthur Road, Ottawa, Ontario, K1L-6R3, Canada
THE CONFERENCE BOARD, INC.
Avenue Louise, 207 Bte 5, B-1050 Brussels, Belgium

THERE IS GROWING INTEREST in the compensation policies of U.S. based multinational companies and the extent, if at all, to which these policies may differ from those of U.S. corporations generally. To what extent, for example, should the senior management of a manufacturing company with a global spread be different from a company of similar size operating only within the U.S. domestic market? Presumably, the talents required to operate the multinational firm differ somewhat from those involved in running one with purely domestic concerns. Does that mean that compensation or compensation patterns should also be different?

This bulletin looks at the compensation paid in 126 of the most internationally involved U.S. manufacturing companies and compares it with a larger sample of nearly 500 manufacturing companies listed on the New York and American stock exchanges. It is hoped that this special analysis will be helpful to executives in multinational companies in the United States and abroad.

The most general conclusion of this analysis is that compensation levels and patterns in U.S. based multinationals do not differ markedly from the U.S. manufacturing industry norms. That finding alone may help put to rest long-standing speculation concerning the impact of global operations on top executive remuneration.

The Multinational Companies

A multinational company, for the purpose of this study, is any manufacturing company that meets any two of the following criteria:

(1) Thirty percent or more of total sales are outside the United States.

(2) Foreign sales are at least $250 million.

(3) Manufacturing operations controlled by the U.S. parent are located in at least five countries.

Based on an analysis of the overseas operations of some 2,000 manufacturers, 200 met the definition: 90 companies met all three criteria, and 110 companies met at least two of them.

Data on the 1983 compensation of their five highest paid executives were obtained for 126 of these manufacturers, from a study of 478 manufacturers with sales of $100 million or more whose stock is listed on the New York or American Exchange[1]. These multinational companies are classified in the tabulation below according to their 1983 sales volume.

1983 Sales	Companies	
	Number	Percent
$10 billion or over	20	16%
5—9,999 billion	16	13
4—4,999 billion	10	8
3—3,999 billion	18	14
2—2,999 billion	12	10
1—1,999 billion	22	17
500—999 million	15	12
100—499 million	13	10
Total	126	100%

Median sales for the group are $3.1 billion, with the middle half ranging between $1.2 billion and $6.1 billion.

Total Compensation

For each multinational manufacturer, compensation data were obtained for the five highest paid executives without regard to title or function. The highest paid executive is almost always the chief executive officer, and the second highest paid, the chief operating officer.

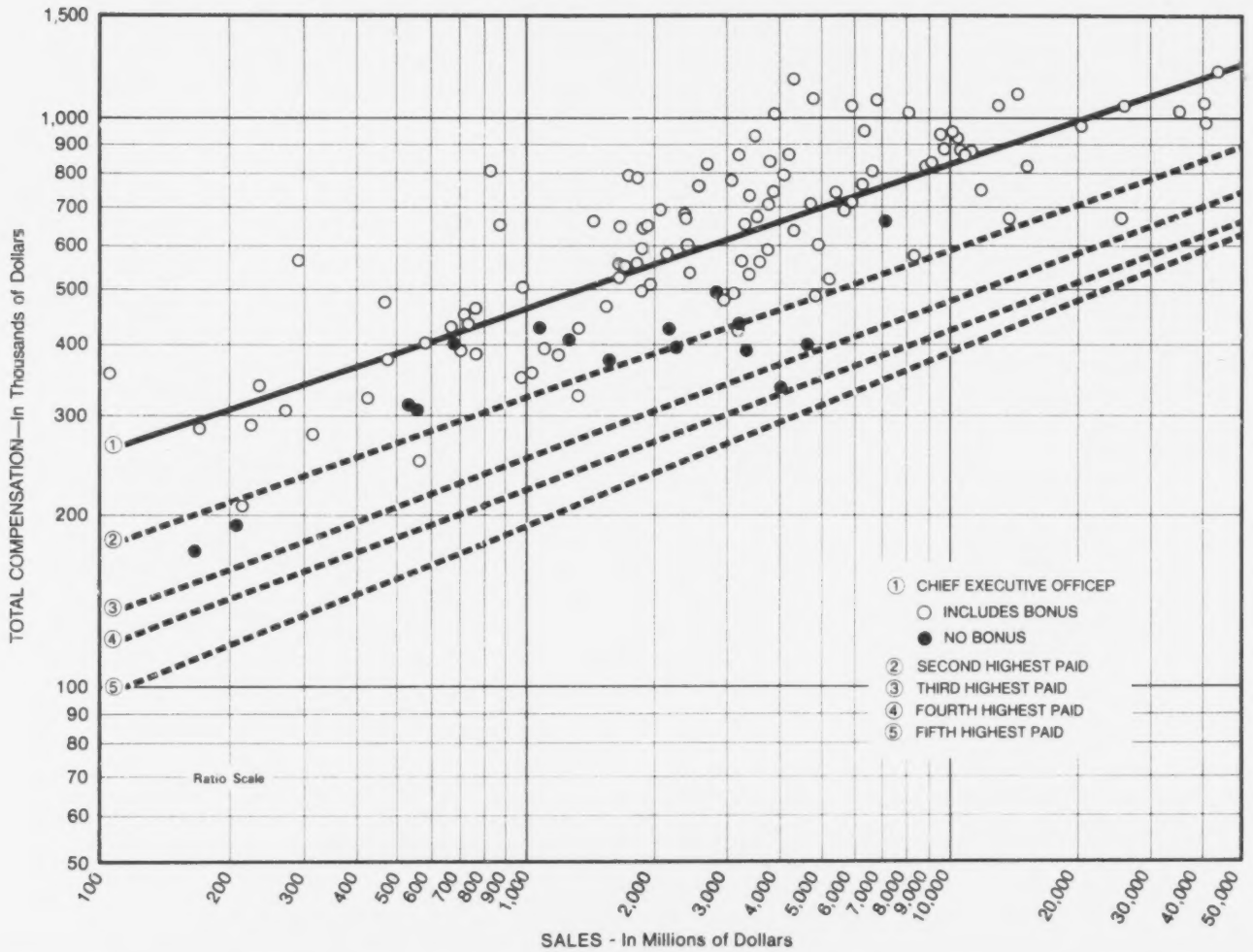
The 1983 *total compensation* of each of the five highest paid executives in each company is measured as the sum of the 1983 salary and 1983 bonus award. The median and middle 50-percent range of the total compensation of the chief executive officers and the other four executives are shown below.

Compensation Rank	1983 Total Compensation	
	Median	Middle 50 Percent Range
Highest Paid	$637,000	$425,000 to $825,000
Second	404,000	280,000 to 564,000
Third	333,000	235,000 to 451,000
Fourth	295,000	210,000 to 395,000
Fifth	262,000	180,000 to 360,000

As the regression lines of Chart 1 (page 4) illustrate, there is a positive relationship between the level of total com-

[1] See Harland Fox, *Top Executive Compensation 1985 Edition*, The Conference Board, Report No. 854, 1984, Chapter 2.

Chart 1. **Total Compensation; Five Highest Paid Executives**



pensation and sales volume for all five executives. The correlation coefficients for the five lines are, respectively: 0.82; 0.82; 0.84; 0.83; and 0.86.

The regression lines on the chart can be used to determine the average compensation of an executive at any level of company sales, either by a direct reading from the chart or by using the regression formulas below. (In these formulas, Y is total compensation stated in *thousands* of dollars; that is, $532,000 is 532. X is sales volume stated in *millions* of dollars; that is, $248,000,000 is 248.)

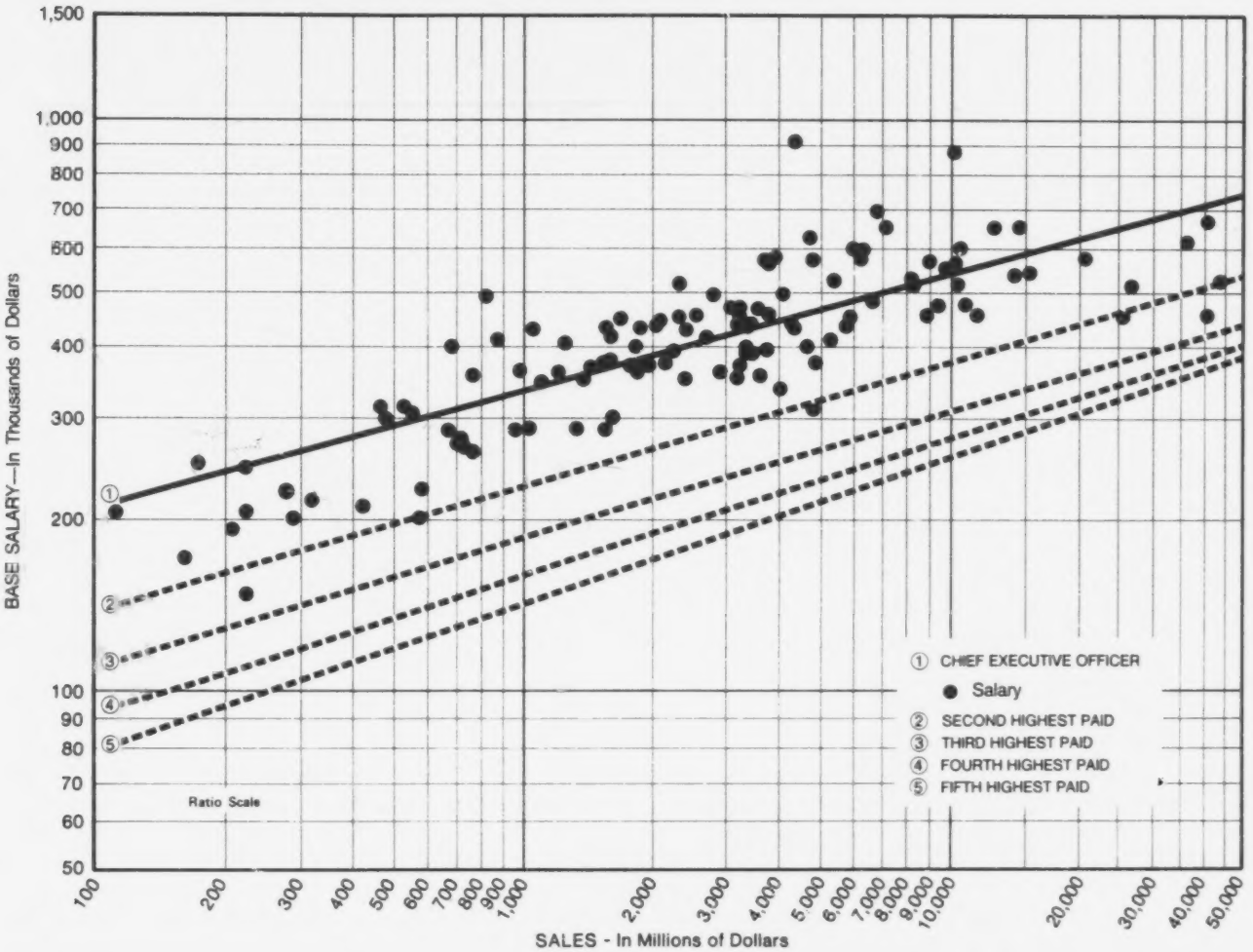
Rank	Regression Formula	r^2
Highest paid	$\log Y = 1.8378 + 0.2727 \log X$	68%
Second	$\log Y = 1.6411 + 0.2818 \log X$	67
Third	$\log Y = 1.4854 + 0.2992 \log X$	70
Fourth	$\log Y = 1.4312 + 0.2984 \log X$	69
Fifth	$\log Y = 1.3106 + 0.3191 \log X$	74

Although total compensation and sales are highly related, company size is not the sole determinant of total compensation levels. As the "coefficients of determination" (r^2) above indicate, the variation in sales volume statistically explains only 68 to 74 percent of the variation in total compensation of the five top-paid executives.

The ratio of the total compensation of each executive to that of the chief executive officer is shown below.

Compensation Rank	Total Compensation as a Percentage of CEO's Total Compensation	
	Median	Middle 50 Percent Range
Second highest	70%	61% to 79%
Third highest	54	48 to 63
Fourth highest	48	42 to 57
Fifth highest	43	37 to 50

Chart 2. **Base Salary; Five Highest Paid Executives**



Salary

The median and middle 50 percent range of the *base salary* of the five highest paid executives are shown below.

Compensation Rank	1983 Base Salary	
	Median	Middle 50 Percent Range
Highest paid	$425,000	$350,000 to $510,000
Second	290,000	220,000 to 370,000
Third	235,000	175,000 to 305,000
Fourth	205,000	165,000 to 265,000
Fifth	190,000	140,000 to 240,000

Again, there is a strong relationship between the level of base salary and company sales volume, as illustrated on Chart 2. The correlation coefficients for the five lines are, respectively: 0.83; 0.77; 0.82; 0.83; and 0.84. The equations for these lines are shown below.

Rank	Regression Formula	r^2
Highest paid	$\log Y = 1.8803 + 0.2119 \log X$	69%
Second	$\log Y = 1.7114 + 0.2156 \log X$	60
Third	$\log Y = 1.5657 + 0.2318 \log X$	67
Fourth	$\log Y = 1.4752 + 0.2414 \log X$	69
Fifth	$\log Y = 1.4032 + 0.2498 \log X$	70

As the "coefficients of determination" (r^2) indicate, the variation in sales volume statistically explains 60 to 70 percent of the variation in base salary of the five top-paid executives. These coefficients are essentially similar to the coefficients for total compensation shown earlier.

Table 1: Annual Bonus Awards, Five Highest Paid Executives

1983 Bonus Awards (Percent of Salary)	Chief Executives		Second Highest Paid		Third Highest Paid		Fourth Highest Paid		Fifth Highest Paid	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
100% or more	8	7%	7	7%	7	6%	8	7%	5	5%
90—99	4	4	2	2	–	–	2	2	3	3
80—89	6	6	5	5	5	5	1	1	5	5
70—79	11	10	9	8	9	8	10	9	6	5
60—69	23	22	20	19	16	14	10	9	10	9
50—59	17	16	23	21	17	15	26	24	18	16
40—49	13	12	12	11	19	17	16	15	21	19
30—39	7	6	10	9	13	12	14	13	17	15
20—29	10	9	12	11	11	10	13	12	9	8
Less than 20%	9	8	7	7	14	13	9	8	17	15
Total	108	100%	107	100%	111	100%	109	100%	111	100%
Median Bonus	58%		55%		50%		50%		44%	
Middle 50% Range	40–71%		35–67%		30–64%		32–64%		32–61%	
Median Salary	$432,000		$294,000		$239,000		$207,000		$192,000	

The ratio of the base salary of each executive to that of the chief executive officer is shown below.

Compensation Rank	Base Salary as a Percentage of CEO's Salary: Median	Middle 50 Percent Range
Second highest	72%	61% to 79%
Third highest	56	50 to 64
Fourth highest	50	44 to 55
Fifth highest	45	38 to 52

These base-salary ratios are essentially the same as the total compensation ratios.

Annual Bonus Awards

All but eight of the 126 multinational manufacturers have an "annual" bonus plan; that is, a plan that pays a year-end bonus that is based on that year's corporate financial performance. Based on bonus awards for 546 executives, the median bonus was the equivalent of 52 percent of base salary.[2] The middle half of the awards ranged between one-third and two-thirds of base salary.

In general, the bonus award tends to increase as a percentage of salary as base salary increases. This explains, in part, why the median award for the chief executive officers, 58 percent of salary, is larger than that for the second highest paid, 55 percent; the third and fourth highest paid, 50 percent; and the fifth highest paid, 44 percent of base salary. (See Table 1.) Similarly, bonus awards for each of the five executives tend to increase as the size of the company increases, as does base salary. (See Table 2.) Data from the table are derived from the regression equations below which are based on the pay of executives in 104 companies that paid a bonus. (The coefficients of determination are in parentheses.)

	Total Compensation	
Highest paid	$\log Y = 1.9039 + 0.2593 \log X$	(70%)
Second	$\log Y = 1.7069 + 0.2672 \log X$	(65)
Third	$\log Y = 1.5818 + 0.2770 \log X$	(70)
Fourth	$\log Y = 1.5506 + 0.2700 \log X$	(70)
Fifth	$\log Y = 1.4405 + 0.2878 \log X$	(73)
	Base Salary	
Highest paid	$\log Y = 1.8992 + 0.2049 \log X$	(69%)
Second	$\log Y = 1.7267 + 0.2088 \log X$	(58)
Third	$\log Y = 1.6044 + 0.2205 \log X$	(66)
Fourth	$\log Y = 1.5217 + 0.2277 \log X$	(67)
Fifth	$\log Y = 1.4716 + 0.2302 \log X$	(68)

Long-term Performance Share/Unit Plans

In recent years, some companies have adopted incentive plans for executives in which the reward is based on

[2] The award for all 580 executives in the 116 companies with an annual bonus plan was not available. Some companies did not pay a bonus to all of the five top-paid executives. Other companies did not separate salary and bonus.

Table 2: Bonus Awards (as Percent of Salary) by Company Size

Executive	Sales Volume		
	$1.2 billion	$3.1 billion	$6.1 billion
Chief Executive Officer			
Bonus (% Salary)	48%	54%	60%
Salary	$341,000	$417,000	$481,000
Second Highest Paid			
Bonus (% Salary)	43%	50%	55%
Salary	$237,000	$291,000	$337,000
Third Highest Paid			
Bonus (% Salary)	43%	49%	54%
Salary	$190,000	$237,000	$277,000
Fourth Highest Paid			
Bonus (% Salary)	46%	50%	53%
Salary	$165,000	$208,000	$245,000
Fifth Highest Paid			
Bonus (% Salary)	43%	48%	52%
Salary	$149,000	$189,000	$223,000

the attainment of specified *long-term* corporate financial performance goals, in contradistinction to the annual bonus plans that are based on a single year's corporate performance.

Under these plans, top executives are given a contingent award of performance units at the beginning of a performance period of three, four or five years. The initial value of each unit usually is the market value of company stock on the date of the contingent award. The actual value of the award is determined by how closely specified corporate financial performance objectives (usually growth in earnings per share) are met over the course of the performance period. As a rule, a new performance period is created each year or, in some cases, every two years; that is, performance periods overlap.[3]

Somewhat more than half (68) of the multinationals have a long-term performance share/unit plan. The plans are more common among the larger companies; for example, 72 percent of the 36 companies with sales of $5 billion or more have a plan compared with 57 percent of the 28 companies with sales of $3 to $5 billion, and 42 percent of the 62 companies with sales under $3 billion.

[3] For an analysis of the characteristics of 89 of these plans, see Harland Fox, *Executive Incentives: Long-Term Performance Share/Unit Plans.* The Conference Board, Research Bulletin No. 132, 1983.

Seventeen companies made a payment during 1983 to one or more of their five top-paid executives under these plans. Payments to 79 executives are shown below, converted to a percentage of their 1983 base salary.

Payment as Percent of Salary	Executive	
	Number	Percent
100% and over	5	6%
50—99	13	16
40—49	17	22
30—39	12	15
20—29	23	30
Less than 20%	9	11
Total	79	100%

The median payment is the equivalent of 35 percent of 1983 salary, with the middle half of payments ranging between 25 and 49 percent of base salary.

Stock Option Plans

As a general rule, the long-term corporate goals on which performance share/unit plans are based are not stated in terms of an increase in the market price of com-

pany stock. Many are an attempt to get away from the vagaries of the stock market; either they are a substitute for a stock option or a complement to it.

By far the most common executive incentive plan, in which the reward is based on the long-term performance of the corporation, is the stock option plan that measures corporate performance solely by the market value of company stock. That is, an executive is given an option to purchase a specified number of shares of stock at a specified price (usually the market price on the date of the grant); the executive may exercise this option to buy during a specified period of time, usually over the ten years following the date of grant.

There are two types of corporate stock options as defined by current tax laws: the "nonqualified" option and the "incentive stock option" (ISO).[4] The major differences between an ISO and a nonqualified option are:

- Under an ISO, the executive is not taxed at the time the option is exercised if the stock is held for a year (and at least two years from the date of grant). When the stock is sold, any gain is taxed at the 20 percent, long term capital gains rate.
- Whan a nonqualified option is exercised, the executive pays tax (at ordinary income tax rates with a top marginal rate of 50 percent) on the spread between the option price and current market value. Any further gain is taxed as a capital gain when the stock is sold.
- No individual may be granted ISO's amounting to more than $100,000 in any year. Nonqualified options may be granted in any amounts.
- ISO's must be exercised in the sequence in which they are awarded. For example, if one ISO was granted at $50 per share and a subsequent ISO at $40 per share, the second grant could not be exercised before the first one even if the current market value climbed back to $50 a share. Nonqualified options have no such restriction on the sequence in which they are exercised.

Ninety percent (113) of the 126 multinational manufacturers have a stock option plan, and almost all (92) made stock option grants during 1983 to their top executives. A small group of companies granted *only* ISO's (13) or *only* nonqualified options (14); the remaining 71 percent granted *both* ISO's and nonqualified options. Among the 65 companies that granted both types of option, 74 percent used the nonqualified option only to make larger awards to those executives whose ISO grant reached the $100,000 limit noted above.

Most (85) of the 92 multinationals that granted options during 1983 provided information about the value of the option grant for one or more of their five top executives. (The value of the option is the number of shares multiplied by the market price at time of grant.) The size of the option grants for 389 executives is shown below, converted to a percentage of 1983 base salary.

Value at Time of Grant (Percent of Salary)	Executives	
	Number	Percent
400% or more	21	5%
300—399	11	3
250—299	16	4
200—249	34	9
175—199	29	7
150—174	31	8
125—149	45	12
100—124	53	14
75—99	32	8
50—74	67	17
25—49	50	13
Total	389	100%

The median value of the option grant for these executives is 122 percent of base salary, with the middle half ranging between 66 and 190 percent. (It should be noted that grants are made each year by most companies.)

The median grant to chief executive officers (134 percent of salary) is higher than that for the second and third highest paid (125 and 120 percent, respectively), and for the fourth and fifth highest paid (116 and 114 percent, respectively).

One or more of the five top-paid executives in 69 companies exercised a stock option during 1983. The net gain realized (current market value minus option price at date of grant) for 215 executives is shown below, converted to a percentage of 1983 base salary.

Gain at Exercise (Percent of Salary)	Executives	
	Number	Percent
400% or more	6	3%
300—399	6	3
200—299	8	4
150—199	13	6
100—149	31	14
75—99	18	8
50—74	33	15
25—49	43	20
15—24	23	11
Less than 15%	34	16
Total	215	100%

The median gain at exercise is the equivalent of 52 percent of base salary, with the middle half ranging between 22 and 112 percent of 1983 salary. In dollar terms, the gain

[4] For an analysis of the characteristics of 189 plans, see Harland Fox, *Incentive Stock Option Plans.* The Conference Board, Research Bulletin No. 148, 1983.

ranged from less than $10,000 to almost $6 million. The median gain was $108,000, with the middle half ranging between $62,000 and $311,000.

Restricted Stock Plans

Restricted stock plans have two major characteristics: (1) The award is an outright grant of company shares; recipients do not have to buy the stock; (2) The shares are forfeitable and nontransferable until the executive completes a specified period of continued employment with the company. The restricted stock grant is, simply, a deffered bonus award, the payout of which is contingent upon continued employment; it is a set of "golden handcuffs" designed to retain selected executives.

This required period of continued employment until *all* shares are released to the executive is the "restriction period." It runs from one to ten years after the date of grant but, most commonly, five years and three or four years. Generally, the executive can vote the shares and receive dividends during this restriction period. Dividends are taxed as received, as though they were additional salary. Similarly, when shares are released to the executive, they are taxed at the market value on the date of release (not date of grant) and taxed as though they were additional salary.[5]

One-quarter (32) of the multinational manufacturers have a restricted stock plan. Almost half (15) of them made an award during 1983. The awards for 71 executives are shown below, converted to a percentage of their 1983 base salary. For this purpose, the value of the award is market value at the time of the award.

Award as	Executives	
Percent of Salary	Number	Percent
200% or more	3	4%
100—199	10	14
40—99	11	15
30—39	13	18
20—29	19	28
Less than 20%	15	21
Total	71	100%

The median award is the equivalent of 31 percent of base salary, with the middle half of the awards ranging between 20 and 75 percent of salary.

[5] Most plans provide for "partial vesting" during the restriction period; that is, some part of the award is made available periodically prior to the end of the restriction period. For an analysis of 91 plans, see Harland Fox, *Restricted Stock for Executives*. The Conference Board, Research Bulletin No. 159, 1984.